

Audit

Report



COMPILING AND REPORTING FY 1999 NAVY GENERAL FUND
INTRAGOVERNMENTAL TRANSACTIONS

Report No. D-2000-146

June 12, 2000

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Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
OMB	Office of Management and Budget
USD(Comptroller)	Under Secretary of Defense (Comptroller)



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

June 12, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Compiling and Reporting FY 1999 Navy General Fund
Intragovernmental Transactions (Report No. D-2000-146)

We are providing this report for review and comment. We conducted the audit in support of our annual audit of the DoD Agency-wide financial statements for FY 1999, as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Because no comments were received on the draft report, we request that the Director, Defense Finance and Accounting Service Cleveland Center, provide comments on the final report by July 12, 2000. Recommendations to the Under Secretary of Defense (Comptroller) included in a draft of this report have been deleted because similar recommendations were included in Report No. D-2000-144, "Compiling and Reporting FY 1999 Department of the Navy Working Capital Fund Intragovernmental Transactions," June 9, 2000.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Hoa H. Pham at (703) 604-9588 (DSN 664-9588) (hpham@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in cursive script, reading "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-146

June 12, 2000

(Project No. D2000-FC-0046.002)

Compiling and Reporting FY 1999 Navy General Fund Intragovernmental Transactions

Executive Summary

Introduction. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare annual audited financial statements. This is the third in a series of reports related to the FY 1999 Department of the Navy (Navy) General Fund financial statements. For FY 1999, the Navy reported \$125.8 billion in assets, \$54.4 billion in liabilities, \$83.9 billion in budget authority, and \$8.1 billion in intragovernmental transactions. Intragovernmental transactions are transactions that occur within and among general fund organizations, DoD, and the Federal Government. Intragovernmental transactions should be disclosed or eliminated, as appropriate, when an entity prepares consolidated financial statements.

Objectives. The audit objective was to determine whether the Defense Finance and Accounting Service Cleveland Center consistently and accurately compiled and reported intragovernmental transactions for the FY 1999 Navy General Fund financial statements. We also reviewed the Defense Finance and Accounting Service Cleveland Center management control program as it related to our objective.

Results. FY 1999 was the first year that the Defense Finance and Accounting Service Cleveland Center accumulated and reported intragovernmental transactions for the Navy, and it made a commendable effort in identifying and reporting \$8.1 billion of intragovernmental transactions for the Navy. However, because of the lack of guidance, complete standard general ledger control systems, and effective policies and procedures, the Defense Finance and Accounting Service Cleveland Center was not able to identify and report all intragovernmental transactions consistently and accurately. As a result, FY 1999 financial statements of the Navy were subject to misstatement and could not be relied on to be a complete and accurate presentation of financial reporting. The FY 1999 DoD-wide financial statements were also similarly affected.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Cleveland Center, maintain audit trails for all intragovernmental accounts receivable, revenue, and unearned revenue obtained from

other trading partners for all levels; reconcile seller-side and buyer-side information; and document procedures used to collect, verify, and report intragovernmental transactions.

Management Comments. The draft report was issued on March 31, 2000, and we received no comments. We request the Director, Defense Finance and Accounting Service Cleveland Center, respond to the final report by July 12, 2000.

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Background

Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to submit to the Office of Management and Budget (OMB) annual financial statements that the Inspector General, DoD, audited. This is the third in a series of reports related to the FY 1999 Department of the Navy¹ General Fund financial statements. Appendix A shows the other two reports under Prior Coverage. This report discusses the reliability and effectiveness of the policies and procedures used to report intragovernmental transaction information for the FY 1999 Navy General Fund financial statements.

Accounting Functions and Responsibilities. The DFAS Cleveland and Kansas City Centers provide finance and accounting support to the Navy and Marine Corps. The support includes maintaining accounting records and preparing financial statements from general ledger records and status-of-appropriation financial data submitted from the field organizations. The DFAS Cleveland Center is responsible for compiling financial information that other Navy organizations submit. The FY 1999 Navy General Fund financial statements reported assets of \$125.8 billion, liabilities of \$54.4 billion, and budget authority of \$83.9 billion.

Transactions Requiring Elimination. Intragovernmental transactions are transactions that occur within and among general fund organizations, DoD, and the Federal Government. When an entity prepares consolidated financial statements, it should eliminate the effect of financial transactions among its components and should report only transactions with outside parties. Government financial statements are also required to show as required supplementary information intragovernmental account balances that reflect entity amounts with other DoD and Federal agencies that should be eliminated in consolidated financial statements of those organizations. Navy General Fund organizations are routinely involved in transactions involving sales and purchases of materials and services with other Navy General Fund and Working Capital Fund organizations, DoD Components, and other Federal agencies. When those kinds of transactions occur, the transactions are to be closed, and when appropriate, eliminated from the various levels of financial statements. Sales of goods or services between Federal entities require three levels of intragovernmental transactions to be identified:

- Level 1: transactions involving sales between DoD and other Federal agencies, such as between the Navy and the Department of Commerce;

¹The Department of the Navy includes both the Navy and Marine Corps. However, in this report, the term "Navy" will refer to the Department of the Navy.

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- Level 2: transactions involving sales between DoD reporting entities, such as between the Navy Working Capital Fund and the Navy General Fund; and
 - Level 3: transactions involving sales between components of the DoD financial reporting entities, such as between Navy General Fund appropriation groupings.

During FY 1999, DFAS Cleveland Center identified \$8.1 billion in intragovernmental transactions for levels 1, 2, and 3. Of the \$8.1 billion in intragovernmental transactions, \$1.9 billion in receivables and \$1.3 billion in revenue were eliminated from the FY 1999 Navy General Fund financial statements.

Objectives

The audit objective was to determine whether DFAS Cleveland Center consistently and accurately compiled and reported intragovernmental transactions for the FY 1999 Navy General Fund financial statements. We also reviewed the DFAS Cleveland Center management control program as it related to our objective. Appendix A discusses the audit scope and methodology and our review of the management control program.

Identifying and Reporting Intragovernmental Transactions

DFAS Cleveland Center made a commendable effort in identifying and reporting \$8.1 billion of intragovernmental transactions for the FY 1999 Navy General Fund consolidated financial statements. However, the process used to account for intragovernmental transactions did not accurately identify and eliminate the effects of all intragovernmental transactions that occurred within and among Navy appropriations and organizations, DoD, and other Federal agencies. The accuracy of the reported intragovernmental transactions was questionable primarily because DFAS Cleveland Center and its supporting accounting offices did not have complete transaction-driven general ledger accounting control systems to accurately identify and report intragovernmental transactions. Also, the conditions occurred because of the following:

- the Under Secretary of Defense (Comptroller) (USD[Comptroller]) did not issue detailed guidance to allow sufficient time for the Military Departments and Defense agencies to implement the guidance in preparing their financial statements while waiting for a permanent solution;
- DFAS Cleveland Center did not have effective management controls needed to ensure that the process used to collect, review, and adjust data among trading partners was thoroughly documented and fully complied with DoD form and content guidance and Key Accounting Requirement² No. 8, "Audit Trails"; and
- departures from reporting requirements were not fully disclosed in the notes to the financial statements.

As a result, the FY 1999 financial statements for the Navy were subject to misstatement and could not be relied on to be a complete and accurate presentation of financial reporting. The FY 1999 DoD-wide consolidated financial statements were also similarly affected.

² DoD Regulation 7000.14-R, "Financial Management Regulation," volume 1, "General Financial Management Information, Systems and Requirements," June 1999, identifies 13 key accounting requirements. Key accounting requirements are a composite of General Accounting Office, OMB, Department of the Treasury, and DoD regulations. All DoD accounting systems must comply with key accounting requirements.

Guidance for Reporting Intragovernmental Transactions

OMB Guidance. OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, and its amendment M-99-03 dated November 20, 1998, require agencies to show consolidated financial statements adjusted for intra-entity eliminations.

DoD Guidance. To implement the OMB reporting requirements, each fiscal year, the USD(Comptroller) develops and issues policy for the Military Departments and Defense agencies to implement in preparing their financial statements. Because of the systemic problems in the DoD accounting and financial management systems, DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6B, "Form and Content of Department of Defense Audited Financial Statements," is updated annually to reflect the progress made to its current systems. For FY 1999, volume 6B was updated in October 1999. However, the implementing guidance on intragovernmental transactions was not included in volume 6B. In November 1999, DoD issued draft guidance on intragovernmental transactions, but the draft guidance was never finalized.

DFAS Interim Guidance. The DFAS drafted chapter 13 to volume 6B, DoD Regulation 7000.14-R, on August 31, 1999 (this report will refer to it as DFAS interim guidance). The DFAS interim guidance was issued as a result of the recommendation made by Inspector General, DoD, Report No. 98-204, "Reporting and Disclosing Intragovernmental Transactions for the FY 1997 DoD Consolidated Financial Statements," September 21, 1998, and Naval Audit Service Report No. 048-99, "Fiscal Year 1998 Department of the Navy Principal Statements and Working Capital Fund Consolidated Financial Statements Eliminating Entries," July 22, 1999. The DFAS interim guidance requires that DoD accounting centers and DoD Components work internally, and with their customers, to extract seller-side information from their intragovernmental (DoD and non-DoD) trading partners because DoD presumed that the amounts of intragovernmental accounts receivable, revenue, and unearned revenue reported by the seller are correct. Furthermore, the guidance states that specific seller-side intragovernmental balances should be exchanged and compared with summary buyer-side data at the appropriation or Defense Working Capital Fund business-area level in an effort to review and adjust intragovernmental activity and prepare annual financial statements that eliminate the effect of intra-entity transactions. Because the USD(Comptroller) had not finalized its draft guidance, DFAS Headquarters instructed all the DFAS centers to use the DFAS interim guidance to accumulate and report FY 1999 intragovernmental transactions.

Processing Intragovernmental Transactions

The following table shows a breakout of the \$8.1 billion of intragovernmental data shown on worksheets that DFAS Cleveland Center prepared for the Navy General Fund.

Summary of Seller Data Used for Intragovernmental Eliminations (in thousands)				
<u>Elimination Level</u>	<u>Accounts Receivable</u>	<u>Revenue</u>	<u>Unearned Revenue</u>	<u>Total</u>
Level 1	\$ 163,480	\$ 797,871	\$0	\$ 961,351
Level 2	558,061	3,408,280	0	3,966,341
Level 3	<u>1,888,546</u>	<u>1,337,003</u>	<u>0</u>	<u>3,225,549</u>
Total	\$2,610,087	\$5,543,154	\$0	\$8,153,241

However, the process that DFAS Cleveland Center used to account for intragovernmental transactions did not accurately identify and eliminate the effects of all intragovernmental transactions that occurred within and among Navy appropriations and organizations, DoD, and other Federal agencies.

Adjusting to the Seller Records. Because of the lack of reliable accounting and financial information, DFAS Cleveland Center could not use the data in the departmental-level general ledger accounts as a source for accumulating, eliminating, and reporting intragovernmental transactions. Instead, DFAS Cleveland Center used the seller information on accounts receivable, revenue, and unearned revenue as basis for reporting intragovernmental transactions. However, using the sellers' information to report intragovernmental transactions resulted in a series of adjustments because the amounts recorded for accounts receivable, revenue, and unearned revenue in the sellers' records differed from the amounts recorded in the departmental-level general ledger accounts. For example, sellers' accounting records showed the total revenue of \$6.5 billion, while the departmental level general ledger showed the total revenue of \$5.1 billion.

Maintaining Audit Trails for Intragovernmental Transactions. The DFAS Cleveland Center was unable to maintain complete audit trails for the \$8.1 billion in intragovernmental transactions reported in the FY 1999 Navy General Fund financial statements. DoD Regulation 7000.14-R, volume 1, "General Financial Management Information, Systems and Requirements," June 1999, requires that audit trails including documentation be maintained so that auditors can ensure that transactions are properly accumulated, classified, coded, and recorded in all affected accounts and later reported in the proper

financial statements. Our review of the process used to collect, review, and adjust data among trading partners before eliminating intragovernmental accounts showed the following:

- DFAS Cleveland Center did not always use the information collected from the trading partners for accounts receivable and revenue as the source for reporting intragovernmental eliminations. Instead, it used the departmental-level general ledger accounts as the primary source for reporting. Accordingly, DFAS Cleveland Center did not collect information for unearned revenue for all three levels because unearned revenue values were not reported in the departmental-level general ledger accounts.
- DFAS Cleveland Center collected seller-side information only for levels 1 and 2, accounts receivable and revenue, and subtracted level 1 and level 2, accounts receivable and revenue, from the departmental-level general ledger accounts to arrive at level 3, accounts receivable and revenue.
- DFAS Cleveland Center exchanged sellers' information with other trading partners for only level 2.

Reporting Intragovernmental Transactions

The lack of adequate general ledger accounting control systems to accurately accumulate and report financial information caused reported intragovernmental transactions to be unreliable. Also, the lack of timely policy guidance from the USD(Comptroller) and management controls within DFAS Cleveland Center, and failure to comply with DFAS interim guidance, contributed to the unreliability of reported intragovernmental transactions.

Complete Standard General Ledger Accounting Control Systems. DoD Regulation 7000.14-R, volume 1, states that DFAS is to maintain and operate a central double-entry general ledger. The central double-entry general ledger and its subsidiary ledgers and reports serve as the source database for producing financial statements for Military Departments and Defense agencies. However, prior audit reports show that DoD financial accounting systems are not fully compliant with regulatory and statutory requirements. For example, Inspector General, DoD, Report No. D-2000-041, "Deficiencies in FY 1998 DoD Financial Statements and Progress Toward Improved Financial Reporting," November 26, 1999, states that auditors continued to identify and report deficiencies that prevented favorable audit opinions on DoD financial statements. Favorable audit opinions were not possible because of the lack of adequate general ledger accounting control systems for compiling accurate and reliable financial data. The report also states that until DoD deploys financial management systems that comply with the Chief Financial Officers Act of 1990

and the Federal Financial Management Improvement Act of 1996, auditors will not be able to perform sufficient audit work to render a favorable audit opinion on the DoD financial statements.

The Need for Specific Policy Guidance. The USD(Comptroller) did not issue policy guidance in a timely manner to compensate for known systemic problems. Such systemic problems included the lack of complete transaction-driven general ledger accounting control systems. Naval Audit Service Report No. 048-99 recommended that the USD(Comptroller) and the Director, DFAS, provide detailed specific guidance in a timely manner for processing intragovernmental transactions to ensure consistency and completeness of financial statement reporting and disclosing. The USD (Comptroller) and the Director, DFAS, concurred with the recommendation. However, DoD did not finalize form and content guidance for the FY 1999 financial statements until October 1999, and guidance on intragovernmental transactions was not finalized before issuing this audit report. As a result, the Military Departments, including the DFAS centers, did not consistently and accurately identify and report all intragovernmental transactions.

Inspector General, DoD, Report No. D-2000-144, "Compiling and Reporting FY 1999 Navy Working Capital Fund Intragovernmental Transactions," June 9, 2000, includes specific recommendations to the USD(Comptroller) regarding the need to finalize the draft guidance on intragovernmental transactions and eliminations. Therefore, this report contains no recommendations concerning DoD guidance. In replying to Report No. D-2000-144, the USD(Comptroller) emphasized that identification and elimination of intragovernmental transactions is a Government-wide problem; additional Government-wide guidance is needed, and DoD financial systems are not capable of producing the required information to properly eliminate intragovernmental transactions. Until adequate accounting systems are in place and more detailed Government-wide guidance is issued, DoD plans to issue interim procedures allowing the use of estimates based on percentage allocations of summary balances. The USD(Comptroller) also stated that new interim policy and procedural guidance will be included in the DoD form and content guidance for audited financial statements in DoD Regulation 7000.14-R to aid in the elimination of intragovernmental balances.

The DFAS Cleveland Center Management Control Structure. DFAS Cleveland Center accounting personnel made a commendable effort in identifying \$8.1 billion in intragovernmental transactions as required by OMB. However, additional improvements in the management control program would ensure that the process used to collect and report intragovernmental transactions was thoroughly documented and reviewed and that it fully complied with applicable guidance.

Documentation of Methodology. The DFAS Cleveland Center did not adequately document the procedures and methodologies used to accumulate, prepare, and report intragovernmental transactions for the FY 1999 Navy General Fund financial statements. General Accounting Office, "Standard for Internal Control in the Federal Government," November 1999, requires that all transactions and other significant events be clearly documented, and the

documentation should be readily available for examination. In view of the new reporting requirements by OMB, DFAS Cleveland Center must develop and implement standard operating procedures to guide accounting personnel in preparing the financial statements.

Additional Disclosures. DoD Regulation 7000.14-R states that “where individual line items of the financial statements cannot be obtained or a substitution is made from the requirements herein, the deficiencies must be explained and the reason for noncompliance annotated in the related footnote.” DFAS Cleveland Center did not adequately explain in the notes to the financial statements the reasons for departures from reporting requirements for revenue and accounts receivable. For example, the DFAS Cleveland Center accounting personnel reported \$1.9 billion in intragovernmental transactions for level 3 accounts receivable but reported only \$1.3 billion for level 3 earned revenue. Because of the lack of audit trails, we were unable to determine the actual understated amounts. However, it is unlikely that accounts receivable would be more than earned revenue for the same reporting period, such as claiming \$1.9 billion in accounts receivable for a \$1.3 billion contract. Additional disclosures in the notes to the financial statements would make the intragovernmental transactions for accounts receivable and revenue more useful and fully compliant with DoD form and content guidance.

Ensuring the Completeness and Accuracy of Data That the Sellers Provided. DFAS interim guidance requires DoD accounting centers and DoD Components to place emphasis on ensuring the completeness and accuracy of data that the sellers provided for accounts receivable, revenue, and unearned revenue. Our review of the process that DFAS Cleveland Center used to accumulate levels 1, 2, and 3 intragovernmental eliminating information showed no evidence that those requirements were fully implemented. Also, instead of using the seller’s information to adjust the departmental-level general ledger accounts, DFAS Cleveland Center adjusted the information received from the sellers to match the departmental-level general ledger accounts. For example, total revenue reported in the departmental-level general ledger for revenue was \$5.1 billion for the Navy (excluding the Marine Corps) for all three levels. However, the seller’s accounting records showed total revenue of \$6.5 billion for level 2, which was much higher than the amounts reported in the trial balances for all three levels. To arrive at the revenue for levels 2 and 3, DFAS Cleveland Center did the following:

- reduced the seller’s revenue reported for level 2 from \$6.5 billion to \$3.4 billion because DFAS Cleveland Center believed that the amounts were overstated and because the amounts obtained were much higher than the amounts reported in the general ledger for all three levels, and
- subtracted the revenues for levels 1 and 2 from the amount reported from the general ledger to arrive at level 3 revenue.

That practice was not in compliance with DFAS interim guidance, which requires that the accounting centers maintaining the departmental-level general

ledger accounts for the buyer-reporting entity make departmental-level adjusting entries to balance the appropriate account balances with the seller's records.

Reporting Unearned Revenue. The FY 1999 Department of the Navy consolidated financial statements did not include intragovernmental eliminating entries for unearned revenue. The financial statements lacked the entries because DFAS Cleveland Center used the departmental-level general ledger accounts as a basis for collecting and reporting intragovernmental eliminations for accounts receivable, revenue, and unearned revenue. Because the general ledger accounts showed zero for unearned revenue, DFAS Cleveland Center did not attempt to collect and exchange information to other trading partners. However, DFAS interim guidance requires DoD accounting centers and Army Corps of Engineers financial centers to accumulate seller-side data and use them to adjust buyer-side accounts at the reporting entity level. The guidance further requires DoD accounting centers to work with all level 1, 2, and 3 trading partners to obtain their aggregate accounts receivable, revenue, and unearned revenue amounts for the appropriation groups.

Because DFAS Cleveland Center did not collect the seller-side unearned revenue, we obtained and reviewed FY 1999 Army, Air Force, and Other Defense Organizations' financial statements to determine whether the sellers' unearned revenue was reported in those statements. Our analysis showed that unearned revenues were reported in the financial statements for all three organizations reviewed.

Appropriation Groupings. Because of time constraints and the lack of specific guidance, DFAS Cleveland Center was unable to obtain support from supporting accounting offices for allocating the \$5.5 billion of earned revenue to each appropriation group as required by the DFAS interim guidance. Accordingly, DFAS Cleveland Center accounting personnel arbitrarily allocated more than 71 percent, or \$4 billion of earned revenue, to the Operation and Maintenance appropriation and allocated the remaining \$1.5 billion to the other five appropriation groups. That practice was not in compliance with the interim guidance, which requires DoD accounting centers to work with levels 1, 2, and 3 trading partners to obtain their aggregate accounts receivable, revenue, and unearned revenue for the appropriation group or business area levels for which they provide service.

Basic Budgetary and Proprietary Journal Entries. The reliability of the two journal vouchers, totaling \$506 million, made by DFAS Cleveland Center to adjust the Operation and Maintenance and Procurement appropriation groups to match the sellers' information for accounts payable was questionable because certain proprietary and budgetary accounts were omitted from the journal vouchers. Also, the adjustment vouchers were not prepared in accordance with Key Accounting Requirement No. 8, "Audit Trails," which states that the financial transactions on accounting system processes must be adequately supported with pertinent source documents. Also, the omission of certain proprietary and budgetary accounts caused the Consolidated Statement of Net Cost, Statement of Budgetary Resources, and Statement of Changes in Net Position to be understated by the corresponding amount.

Conclusion

FY 1999 was the first year that DFAS Cleveland Center accumulated and reported intragovernmental transactions for the Department of the Navy with little or no guidance from DoD. However, the \$8.1 billion in intragovernmental transactions reported in the Navy General Fund consolidated financial statements were not reliable and were of limited use. Problems in identifying and reporting intragovernmental transactions occurred because of the long-standing DoD problems with accounting and financial management reporting and the lack of timely guidance from the USD(Comptroller). In addition, DFAS Cleveland Center had management control weaknesses in procedures for documenting, collecting, compiling, and reporting intragovernmental transactions.

Recommendations

Deleted Recommendation. We deleted draft report Recommendation 1. for the USD(Comptroller) to revise guidance because Inspector General, DoD, Report No. D-2000-144 made a similar recommendation. In order to avoid a duplication, we deleted the recommendation in this report. We renumbered the other recommendations accordingly.

We recommend that the Director, Defense Finance and Accounting Service Cleveland Center:

1. Maintain records for audit trails in accordance with Key Accounting Requirement No. 8, "Audit Trails," for the amounts of intragovernmental accounts receivable, revenue, and unearned revenue obtained from the sellers for levels 1, 2, and 3.
2. Develop and implement documented procedures to collect, verify, and adjust financial data obtained from other trading partners.
3. Disclose reasons and causes in the notes to the financial statements if accounts receivable are higher than revenues for the same accounting period.
4. Collect, review, exchange, and reconcile seller-side and buyer-side information for all three levels, and disclose reasons for all exceptions in the notes to the financial statements.
5. Maintain records for audit trails for the amounts of intragovernmental accounts receivable, revenue, and unearned revenue allocated to each appropriation group.
6. Make accounting adjusting entries for both proprietary and budgetary accounts.

Management Comments Required

The Director, Defense Finance and Accounting Service Cleveland Center, did not provide comments on a draft of this report. We request that the Director provide comments on this final report.

Appendix A. Audit Process

Scope

We reviewed the process that DFAS Cleveland Center used for identifying and reporting intragovernmental transactions for FY 1999. We performed a limited review of the process that DFAS Kansas City Center used because the amount reported was not material. Of the \$8.1 billion in intragovernmental elimination transactions reported for FY 1999, \$562 million was reported by DFAS Kansas City Center.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. (01-DoD-2)
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. (01-DoD-2.5)
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. (01-DoD-2.5.1.)
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. (01-DoD-2.5.2.)

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

- **Financial Management Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

We reviewed applicable laws, policies, procedures, and regulations related to the preparation and presentation of intragovernmental eliminating transactions for the DoD annual financial statements. We reviewed the DFAS Cleveland Center accounting records and journal vouchers, and we held discussions with the DFAS Cleveland Center and DFAS Kansas City Center accounting personnel responsible for collecting, reviewing, exchanging, and reporting intragovernmental transactions. We compared and analyzed the information that DFAS Cleveland Center obtained from other trading partners with the information reported in the financial statements.

Use of Computer-Processed Data. We relied on computer-processed data from Standard Accounting and Reporting System-Financial and Departmental Reporting and Standard Accounting and Reporting System-Field Level, and Standard Accounting and Reporting System-Headquarters Command Module to conduct the audit at DFAS Cleveland Center. We relied on computer-processed data without performing tests of the system's general and application controls because the process for accumulating and reporting intragovernmental eliminating transactions at DFAS Cleveland Center is primarily a manual process. Not evaluating the controls did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from December 1999 through February 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contact During the Audit. We visited or contacted individuals and organizations in DoD for the objectives identified in this audit. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland Center management controls over accumulating and reporting intragovernmental transactions that occurred within the DoD General Fund organizations and with other Federal Government organizations. Specifically, we reviewed the procedures and controls that

DFAS Cleveland Center used to collect, review, exchange, and report intragovernmental accounts receivable, revenue, and unearned revenue. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified management control weaknesses at DFAS Cleveland Center, as defined by DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. The DFAS Cleveland Center management controls over accumulating and reporting intragovernmental transactions were not adequate to eliminate the effects of intragovernmental accounting transactions that occurred within the DoD General Fund organizations, and with other Federal Government organizations. Recommendations 1. through 6., if implemented, will improve management controls over reliability of the intragovernmental eliminating entries reporting. A copy of this report will be provided to the senior official responsible for management controls at DFAS Cleveland Center.

Adequacy of Management's Self-Evaluation. The DFAS Cleveland Center did not identify the process for accumulating and reporting intragovernmental transactions within its assessable units and, therefore, did not identify or report the material management control weaknesses identified by this audit.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

The Inspector General, DoD, issued two other reports on the FY 1999 financial statements for the Navy General Fund:

- Report No. D-2000-137, "Accounting Entries and Data Processing for the FY 1999 Department of the Navy General Fund Financial Statements," June 1, 2000.
- Report No. D-2000-081, "Inspector General, DoD, Oversight of the Naval Audit Service Audit of the FY 1999 Department of the Navy General Fund Financial Statements," February 14, 2000.

Appendix B. Report Distribution

Office of the Secretary of Defense

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Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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